

INTERNAL REVENUE SERVICE  
DIRECTOR, EXEMPT ORGANIZATIONS

DEPARTMENT OF THE TREASURY  
P.O. BOX 2508 - TE/GE, Room 7008  
CINCINNATI, OH 45201

Date: MAR 17 2003

Employer Identification Number: [REDACTED]

Contact Person: [REDACTED]

Contact Telephone Number: [REDACTED]

Phone: [REDACTED]

Fax: [REDACTED]

Dear Sir or Madam:

We have considered your application for recognition of exemption from Federal income tax under the provisions of section 501(c)(7) of the Internal Revenue Code of 1986 and its applicable Income Tax Regulations. Based on the available information, we have determined that you do not qualify for the reasons set forth on Enclosure I.

Consideration was given to whether you qualify for exemption under other subsections of section 501(c) of the Code. However, we have concluded that you do not qualify under another subsection.

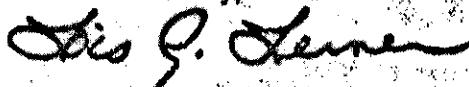
As your organization has not established exemption from Federal income tax, it will be necessary for you to file an annual income tax return on Form 1041 if you are a Trust, or Form 1120 if you are a corporation or an unincorporated association.

If you are in agreement with our proposed denial, please sign and return one copy of the enclosed Form 6018, Consent to Proposed Adverse Action.

You have the right to protest this proposed determination if you believe it is incorrect. To protest, you should submit a written appeal giving the facts, law and other information to support your position as explained in the enclosed Publication 892, "Exempt Organizations Appeal Procedures for Unagreed Issues." The appeal must be submitted within 30 days from the date of this letter and must be signed by one of your principal officers. You may request a hearing with a member of the office of the Regional Director of Appeals when you file your appeal. If a hearing is requested, you will be contacted to arrange a date for it. The hearing may be held at the Regional Office or, if you request, at any mutually convenient District Office. If you are to be represented by someone who is not one of your principal officers, he or she must file a proper power of attorney and otherwise qualify under our Conference and Practice Requirements as set forth in Section 601.502 of the Statement of Procedural Rules. See Treasury Department Circular No. 230.

If we do not hear from you within the time specified, this will become our final determination.

Sincerely,



Director, Exempt Organizations

Enclosures:

Enclosure I  
Form 6018  
Publication 892

## Enclosure I

### Issues

The issues are whether or not [redacted] operates bar facilities that are available to the general public, and whether or not the bar facilities are operated for the benefit of a private shareholder. The application submitted by [redacted] requested tax-exempt status under Section 501(c)(7). An organization cannot be qualified under Section 501(c)(7) if its facilities are made available to the public. Further, an organization cannot be qualified under that section if it is operated for the benefit of a private shareholder.

### Overview

- A = [redacted]
- B = [redacted]
- C = [redacted]
- D = [redacted]

A is located in [redacted]. A is a membership club for patrons of B who wish to buy alcoholic beverages. Each patron must apply for membership to the club and be approved by the membership committee. A's only source of income is beverage sales. Beverage sales pay for the management of the club.

C is a for-profit group that owns B, as well as the clubhouse from which A operates. A has a management agreement with C. The management agreement provides that C receive 30% of the monthly gross sales derived from A's services and management. Also, A has a lease agreement with C. The lease agreement states that rent is 10% of the gross receipts from A's beverage sales. An officer of the Board of Directors of A and C signed both agreements on the behalf of all parties, A and C.

In a correspondence dated [redacted] A's Board President stated that the D requires that all establishments who wish to sell liquor in a dry area must operate as a [redacted] with tax-exempt status from the Internal Revenue Service. However, a copy of [redacted] from the [redacted] does not appear to indicate that tax-exempt status with the Internal Revenue is a requirement for operating a club that serves liquor. A copy [redacted] states that alcohol cannot be consumed "in a public place within the limits of the [redacted]".

### Facts

The evidence presented shows that [redacted] was incorporated in [redacted]. The primary purpose is to maintain and operate a social organization composed of members for the purposes of gathering together.

We received a Form 1024 application postmark dated [redacted] in which you applied for tax-exempt status under Section 501(c)(7) as a social club. The application states [redacted] is a membership club for patrons of the [redacted] who wish to buy alcoholic beverages." It also indicates that each patron must apply for membership to the club and be approved by the membership committee. The proceeds from the sale of alcoholic beverages pay for the management of the club by [redacted].

A correspondence dated [redacted] states "To be served liquor immediately, the current of intended member must have a [redacted] with a valid driver's license." You also indicate that no package liquor for carry out was sold. In



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your [redacted] response to our request for additional clarification, you state, "Yes, anyone, age 21 or above, could walk into our club with a valid [redacted] and driver's license and could immediately be issued membership, and be served liquor." You further explain that you did maintain a membership list, and issue membership cards, but that members do not pay dues, and that the bar over which you serve liquor is your only activity.

Your faxed letter dated [redacted] explains that the [redacted] was a card issued as part of a commercial computerized membership tracking system that is used by private clubs to maintain membership records, and identify members who present themselves as members at private clubs. However, the [redacted] letter also states that "Anyone 21 years of age who enters our club and wishes to be served alcohol must present a valid driver's license as proof of age. If this person is not already a member of our club, he/she must fill out an application for membership. A temporary membership will be issued which is valid for three days." It also states that "Club members make up [redacted] % of our officers and membership committees. Our business is strictly for social purposes. Only members and their guests are served alcohol in our club."

Your correspondence dated [redacted] states that, "The [redacted] is paying [redacted] 10% of the gross monthly alcohol sales for lease fees and 30% of the gross monthly alcohol sales for management fees. These percentages are based upon the need for [redacted] % of the monthly sales of alcohol to replenish the liquor/beer/wine inventory, pay [redacted] charges, and to pay the monthly beverage taxes of [redacted] %."

## Law

Section 1.501(c)(7)-1 of the Regulations, Social clubs, provides that

(a) The exemption provided by section 501(a) for organizations described in section 501(c)(7) applies only to clubs which are organized and operated exclusively for pleasure, recreation, and other non-profitable purposes, but does not apply to any club if any part of its net earnings inures to the benefit of any private shareholder. In general, this exemption extends to social and recreation clubs which are supported solely by membership fees, dues, and assessments. However, a club otherwise entitled to exemption will not be disqualified because it raises revenue from members through the use of club facilities or in connection with club activities.

(b) A club which engages in business, such as making its social and recreational facilities available to the general public or by selling real estate, timber, or other products, is not organized and operated exclusively for pleasure, recreation, and other non-profitable purposes, and is not exempt under section 501(a). Solicitation by advertisement or otherwise for public patronage of its facilities is prima facie evidence that the club is engaging in business and is not being operated exclusively for pleasure, recreation, or social purposes. However, an incidental sale of property will not deprive a club of its exemption. [Reg. §1.501(c)(7)-1.]

A private shareholder is defined in Section 1.501(a)-1(c) of the Regulations, Exemption from taxation, provides that:

(c) "Private shareholder or individual" defined. The words "private shareholder or individual" in section 501 refer to persons having a personal and private interest in the activities of the organization.

In Revenue Ruling 58-589, 1958-2 C. B. 266 provides that "A club which engages in business, such as making its social and recreational facilities available to the general public or by selling real estate, timber, or other products, is not operated exclusively for pleasure, recreation, and other non-profitable purposes."

## Application of Law

We have determined that your organization does not meet the requirements of Section 1.501(c)(7)-1(b) of the Regulations. Like Revenue Ruling 58-589, your bar facilities are available to the public, which is prohibited by Section

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1.501(c)(7)-1(b).<sup>4</sup> Your bar facilities are available to the public, because anyone meeting the basic legal age requirements to drink liquor can enter your bar facilities, and after completing a membership application, be issued a temporary membership, and immediately be served liquor. This constitutes operating bar facilities that are available to the general public.

We further determined that your organization does not meet the requirements of Section 1.501(c)(7)-1(a), because [redacted] benefits financially from its relationship with [redacted] in excess of what would reasonably be considered to be ordinary, prudent business practices. This constitutes prohibited inurement to a private shareholder [redacted]. We reached this conclusion because [redacted] receives rent and management fees from [redacted] that amount to the entire estimated excess of revenues over expenses [redacted] from the [redacted] bar sales. Since the officers serve on both boards of directors of [redacted] and [redacted], there is a clear absence of arm's length transaction. Therefore, paying over all of its potential profits to [redacted] is not an ordinary and prudent business practice to enter into contract when there is an established conflict of interest.

[redacted] is a private shareholder under Reg. 1.501(a)-1(c) because it owns the club facilities that are rented to [redacted], and it also owns the [redacted]. The application submitted states that the bar facilities are operated for the benefit of [redacted] patrons.

### Taxpayer's Position

The [redacted] does not believe that its facilities are available to the general public because only club members and their guests can be served alcohol in the club. Therefore, [redacted] is operated by its members, and for the benefit of its members.

[redacted] is paying [redacted] % of the gross monthly alcohol sales for lease fees and [redacted] % of the gross monthly alcohol sales for management fees. These percentages are based on the need for [redacted] % of its gross monthly sales of alcohol to replenish the liquor/beer/wine inventory, pay [redacted] charges and to pay the monthly beverage taxes of [redacted] %.

Also, [redacted] has stated that it must have a tax-exemption letter from the Internal Revenue Service in order to receive a [redacted] to serve liquor from the [redacted].

### Service Response To Applicant's Position

Your organization operates in a commercial manner. Your organization allows anyone of legal drinking age to enter the bar facilities, and be served liquor almost immediately means that in practice, the bar facilities are available to the public. Even though a non-member must complete a membership application at the bar facilities before they can be served liquor, it is a formality, and the membership issue thereon is a temporary three-day membership. The temporary membership process practiced by [redacted] is used for the purpose of allowing the general public access to the bar, and to increase bar receipts.

The requirement that [redacted] must turn over the entire excess of the revenues over expenses that result from its bar operations is not a common, or realistic business arrangement, and results in an excessive benefit to the [redacted]. [redacted] benefited from its position as owner of the building that houses [redacted], and also as owner of the [redacted].

Also, the copies of [redacted] and the [redacted] sent to us by [redacted] do not indicate that it is necessary for a private club to have a tax-exemption letter from the Internal Revenue Service in order to be issued a liquor license.



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Conclusion

Since its bar facilities are available to the general public, and [REDACTED] operates in a commercial manner, Brickyard Five, Inc does not operate exclusively for pleasure, recreation, and other non-profitable purposes as described under Section 501(c)(7) (b) of the Regulation.

[REDACTED] receives excessive compensation from [REDACTED] for management and rental fees, because those fees represent all of the profits from the bar operations. Since [REDACTED] is a private shareholder, as defined under Section 1.501(a)-1(c); the result is inurement to [REDACTED] which is described in Section 1.501(c)(7)-1(a) of the Regulation.